



Review of the Effectiveness of Virginia Tax Preferences

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BACKGROUND

Like most states, Virginia uses tax preferences to achieve specific public policy or tax policy goals. Tax preferences are provisions in the tax code—such as exemptions, deductions, or credits—that decrease the tax liability of eligible taxpayers and ultimately reduce the amount of revenue that the state collects. Because tax preferences are not subject to Virginia's budgetary process, they often remain in effect, sometimes indefinitely, without any evaluation of their effectiveness. Little information is available about tax preferences, including which ones should be continued because they are effective and which ones could be revised to improve their effectiveness, or eliminated altogether.

Tax preferences collectively reduced taxpayers' liability by approximately \$12.5 billion in tax year 2008, which represents nearly 90 percent of the amount of state revenue collected from the corporate income, individual income and retail sales and use tax systems. Of that amount, the tax preferences aimed at achieving public policy goals, such as providing financial incentives or encouraging particular activities, accounted for about \$2.9 billion in reduced tax liability.

KEY FINDINGS

In our review of the tax preferences available in Virginia through the corporate income, individual income, and retail sales and use tax systems, we noted the following:

- Changes to preferences with tax policy goals, such as increasing the efficiency of the tax system and avoiding double taxation, could negatively affect the state's tax systems. Changing the retail sales and use tax exemption on services, however, could improve the reliability and equitability of that tax system.
- Virginia's tax preferences aimed at providing financial assistance achieve their goals, but some could be more efficiently targeted to their intended beneficiaries. For example, the financial assistance provided through sales tax preferences tends to disproportionately accrue to higher income taxpayers. Even tax preferences that are granted based on low income levels tend to provide a greater share of the overall reduction in tax liability to higher income taxpayers.
- The effectiveness of tax preferences designed to promote specific activities is mixed. While land and historic preservation tax credits appear to effectively achieve their goals, others, such as coal tax credits, do not.
- Virginia makes limited use of sunset dates and periodic reviews as mechanisms to identify effective preferences and improve or eliminate ineffective ones.

SUMMARY OF RECOMMENDATIONS

- A joint subcommittee should be created to oversee the evaluation of Virginia's tax preferences on an ongoing basis. The joint subcommittee would be made up of House Finance, House Appropriations, and Senate Finance committee members. It should meet at least annually to consider whether tax preferences should be continued, revised, or eliminated. It should also conduct public hearings and report its recommendations to the General Assembly.
- At the direction of the joint subcommittee, the Department of Taxation should conduct independent evaluations of tax preferences. An advisory group of tax and economic policy experts could be created to provide technical assistance.